

New Mega-Trade Deals

What implications for Africa?

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Key messages

The stalemate at the WTO over the last two decades has been accompanied by a proliferation of bilateral and regional trade agreements, and more recently mega trade agreements, such as TTIP, TTP, RCEP and FTAAP.

Mega trade deals will have an impact on trade flows, on the direction and intensity of investment, on the structure of regional and global value chains, and will redefine the 'rules of the game'.

Mega-trade deals are expected to be about WTO-plus issues and WTO-extra issues

For Africa, mega trade deals will likely (i) lead to an erosion of the margin of preferences they enjoy to big markets; (ii) further entrench the position of Africa as rule/standard taker.

African policy makers need to think 'outside the box' to forge strategic responses and alliances to avoid marginalisation and being rule-takers.

1. Background

In the last two decades, negotiations to advance rules on international trade at the multilateral level, notably through the World Trade Organization (WTO), have become extremely difficult. There are several reasons for that:

1. A large membership – 160 members – makes it increasingly difficult to find consensus on all issues¹, and in particular, on critical ones (like agriculture);
2. Emerging global powers, in particular since China joined in 2001, have been increasingly active and vocal in negotiations to mark their differences and put forward their economic interests. Difficulties therefore to agree on common grounds have slowed down progress;

¹ Decisions are taken by consensus and guided by the principle of 'single undertaking', that is, all items are negotiated as part of an indivisible package and nothing is agreed until everything is agreed.

3. The changing nature of trade over the past decades is calling for a new approach to the multilateral trading system. Today, it is estimated that about 60% of global merchandise trade takes place in trade in intermediaries and the share of trade in services (and in tasks) has become more important than trade in goods. It is therefore felt that the current global trade architecture, as reflected by the WTO agreements, no longer reflects the reality of today's global trade dynamics. The current stalemate in agreeing on existing issues makes it even more difficult to advance on new issues.

As a reaction to the above, the world has seen a proliferation of bilateral and regional trade agreements (RTAs), not only between developed and developing countries, but more and more now among developed countries. This new generation of mega trade agreements² among developed nations and key emerging ones are strategic in nature, as they are not only a way to consolidate trade ties and deepen economic integration but are also expected to largely reshape trade rules to make them fit for the 21st century. The main ones are:

1. **Trans-pacific partnership (TTP)**: 12 countries, namely the US, Japan, Canada, Australia, Singapore, Mexico, Chile, New Zealand, Brunei, Peru, Vietnam and Malaysia. But real/ main negotiations are essentially between the US and Japan, the rest are small countries with little weight.
2. **Transatlantic Trade and Investment Partnership (TTIP)** between the European Union (EU) and the US. The main reason is geopolitical: be the first to set rules and regulatory benchmarks that reflect the nature of the 21st century trading system and advance agendas that are difficult to move at the WTO.
3. A similar trend is also observed among large developing countries, with proposed **Regional Comprehensive Economic Partnership (RCEP)**, a free trade agreement negotiations launched in 2012 among 16 countries, which comprises the 10 member states of the Association of South East Asian Nations (ASEAN) - Brunei, Myanmar, Cambodia, Indonesia, Laos, Malaysia, the Philippines, Singapore, Thailand and Vietnam) - and the six states with which ASEAN has existing free trade agreements (FTAs), namely Australia, China, India, Japan, South Korea and New Zealand.
4. **Free Trade Agreement of the Asia-Pacific (FTAAP)**, a potential association of 21 economies, including China, Russia, Japan, the US, Canada and South Korea.³ On the agenda of the APEC since at least 2004, the need to move faster on such an FTA was raised again at the latest APEC Summit in November 2014, under the leadership of China, left out of the other major mega trade negotiations in the Pacific, the TTP. But negotiations have yet to start, and it is unlikely the US will sideline the TPP for the FTAAP.

If successfully concluded, these mega-trade agreements are likely to impact a significant percentage of global trade, notably by redefining the 'rules of the game'.

Stakes are therefore high, and it is important to measure their potential implications for African economies and the multilateral trading system as a whole.

The main issues at stake are therefore:

1. Will the mega trade agreements succeed in the areas where the WTO has failed?
2. To what extent will these agreements generate (new) trade standards that can be accepted globally or will by default, apply globally?
3. Will countries that are not party to these agreements be marginalised? If yes, what could be done?

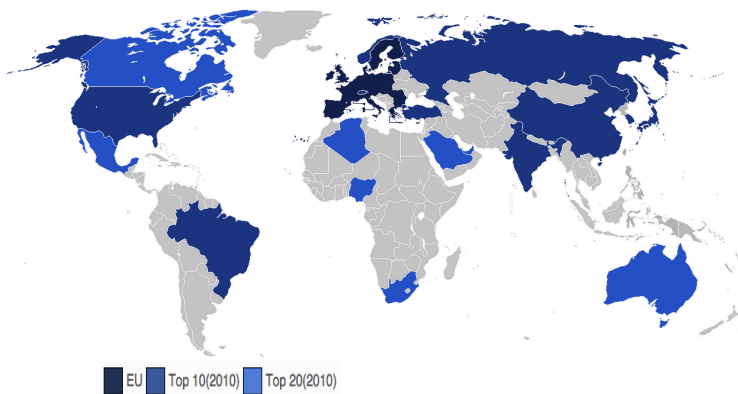
² By mega trade agreements, this note means trade agreements involving two or more 'large economies'.

³ Potential FTAAP members are China, Russia, Japan, US, South Korea, Cambodia, Laos, Vietnam, Myanmar, Australia, New Zealand, Brunei, Malaysia, Singapore, Indonesia, Philippines, Thailand, Canada, Chile, Mexico and Peru.

2. What is the state of play in key markets?

The graphs below illustrate the main trading partners of the EU, the U.S. and China respectively, showing where their interests lie.

Figure 1: EU's main trading partners, 2010



Source: Wikipedia

Figure 2 U.S Main Trading Partners in 2012

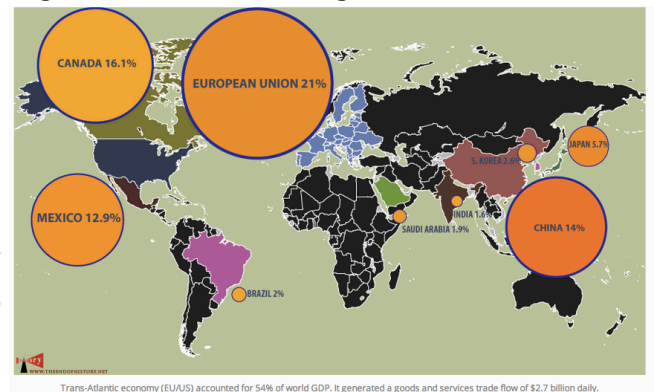
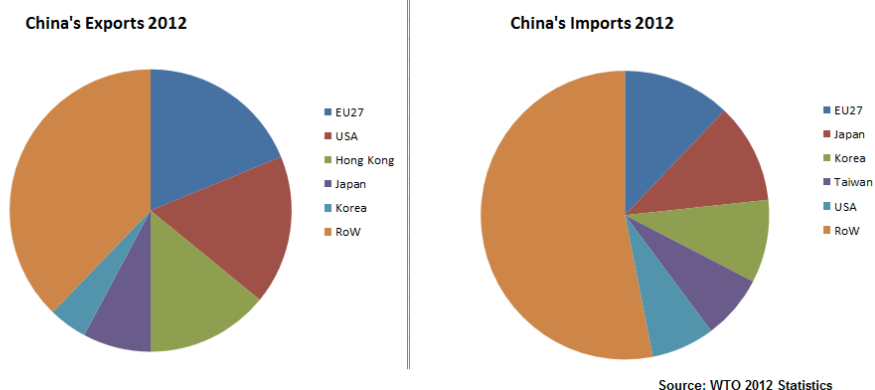


Figure 3 China's main trading partners, 2012



Meanwhile, it is important to highlight that the EU does not yet have FTAs with some of its principal trading partners, as illustrated in the table below. More than 70% of its trade operates through the multilateral system, although it has started negotiations with some key partners. Similarly, the US is yet to have FTAs with key partners such as the EU, Japan or China, which together account for more than 40% of its trade.

Table 1: EU key partners and FTA negotiations

(in grey, concluded or under negotiations; in white, not covered)

Country / Region	Imports	Exports	Trade	% EU28 Trade
USA	205.8	292.5	498.2	14.3
China	291.1	143.9	435.0	12.5
EFTA	209.5	186.3	395.8	11.4
Russia	214.2	123.4	337.5	9.7
ASEAN	100.3	81.4	181.7	5.2
MEDA (excl EU and Turkey)	73.1	93.2	166.7	4.8
GCC	61.2	83.6	144.9	4.2
ACP (excl South Africa)	78.8	61.2	140.0	4.0
Turkey	48.1	75.3	123.4	3.5
Japan	64.5	55.5	120.0	3.4
India	37.5	38.5	76.0	2.2
South Korea	38.0	37.8	75.7	2.2
Canada	30.3	31.3	61.6	1.8
Australia	14.5	33.9	48.4	1.4
Mexico	19.5	28.0	47.4	1.4
South Africa	20.5	25.6	46.1	1.3
Hong Kong	10.5	33.7	44.2	1.3
Ukraine	14.6	23.8	38.4	1.1
Taiwan	22.6	15.8	38.4	1.1
Andean Community	17.8	11.7	29.5	0.8
Central America 6	9.6	5.4	15.0	0.4
Other Countries	211.8	204.8	416.6	12.0
Extra EU28	1,794.0	1,686.4	3480.4	100.0

In Bn € / 2012

Table 2: Combined size of 4 mega-trade deals

Combined economy size, populations of areas covered by 4 mega-FTAs

	Economy ^{**} , in trillions of dollars	Population ^{**} , in millions
TPP (12 participants: U.S., Canada, Chile, Peru, Mexico, Australia, New Zealand, Singapore, Brunei, Vietnam, Malaysia, Japan)	27.6 (38.5)	790 (11.4)
RCEP (16 participants: 10 Asean members, Japan, China, South Korea, India, Australia, New Zealand)	21.2 (29.6)	3,400 (49.0)
TTIP (participants: U.S., EU)	32.3 (45.0)	820 (11.8)
Japan-EU EPA (participants: Japan, EU)	22.5 (31.4)	630 (9.1)

*Nominal GDP for 2012; proportion of world economy in parentheses; in percent

**Estimates for 2012; proportion of world total in parentheses; in percent

Source: Prepared by Jetro based on IMF data

Source European Commission, 2014

3. What may be contained in these mega-trade deals?

Mega-trade deals are deep integration agreements among countries with a major share of world trade and foreign direct investment and which are global drivers or hubs in global value chains (Melendez-Ortiz. 2014). They have two main purposes:

1. They are a way to advance a more ambitious trade agenda that fits the nature of “21st century trade” and are therefore a way for large players to set the “rules of the game” to fit their interests and needs;
2. They are essentially *geopolitical* tools, as a response to the rise of new global trading powers, such as China. This is particularly important in the case of the TPP, which is seen as a way to contain the rise of China in Asia and the Pacific. The recent move of China at the November 2014 APEC Summit to advance the FTAAP agenda as a means to deepen economic integration and interconnectivity across Asia and the Pacific and where it is expected to position itself at the centre piece and main driver, further confirms this argument.

It is important to highlight that mega-trade deals are not only **about tariffs**. In the case of the TPP and the TTIP, the average US and EU tariffs are already quite low, at an average applied most favoured nation (MFN) tariff rate of about 3.5% *ad valorem* for the United States and about 5.5% for the EU. However, tariffs are higher (known as “tariff peaks”) on certain *import-sensitive* product categories such as dairy products, sugar and confectionery, beverages and tobacco, fish and fish products, and textiles and apparel. Given the magnitude of the transatlantic relationship, further elimination and reduction of tariffs could yield significant economic gains. For example, according to one economic estimate, the increased welfare gains from a tariff-only agreement accrued by the EU could be as much as US\$3 billion, and by the United States as much as US\$4.5 billion. In the case of RCEP and FTAAP, tariffs will however certainly matter, given higher level of protection in large developing countries.

One of the main focuses however is likely to be about **regulatory compatibility and convergence and about rules** that affect investments and business environment/competitiveness. It is estimated that *ad valorem* tariff equivalent protection from NTMs range between 19% and 73%.⁴ It is also estimated that up to 50% of those barriers could potentially be eliminated through such deals (Ecorys, 2009). This will therefore set globally relevant regulatory coherence (through mutual recognition agreements) and compatibility, measures such as norms, standards, testing requirements, procedures, technical regulation, food safety etc. Key sectors of interest are likely to include automobiles, chemicals, cosmetics, information communication technologies, medical devices, pesticides, and pharmaceuticals. As a result, third countries (including African countries) are likely to face higher compliance and trade costs to maintain access to these markets, this despite the fact that some of them have concluded FTAs with the EU, for instance.

Mega-trade deals are therefore expected to be largely about:

1. **WTO-plus** issues (i.e. going deeper than what is provided for in WTO agreements) in issues such as regulation, standards, norms, licensing practices, domestic taxes, government procurement, rules on investment, rules on state-trading enterprises; and
2. **WTO-extra** issues, that is to address issues that do not fall within the realm of the WTO agreements, on issues such as human rights; environment; labour rights, data protection, trade facilitation in supply chain management, competition policy, consumer protection etc.

4. What is expected to be the impact of those deals?

These mega-trade deals are likely to reshape global trade rules, while at the same time being discriminatory, by excluding some 160 countries from the negotiations, although, as illustrated in Table 2, they cover a substantial portion of the world economy. This will significantly affect the offensive and defensive interests of all other countries (Dadush, 2014). It is therefore crucial to look at the future trade relationship between Europe and Africa in a broader context. The inter-connectedness between Europe and big players will have spillover effects on EU-Africa trade relations.

4.1. On the multilateral system

Mega-trade deals are likely to have systemic impacts, notably by putting at risk what has been agreed, not without difficulty, at the WTO.

First, they may shift the attention away from the WTO for a while, therefore putting on hold any efforts to try to unlock the current stalemate. It is feared that the current issues that are of significant importance for developing countries, such as food security, agriculture subsidies, climate change etc., will be side-lined, with no possibility to negotiate trade-offs.

Second, in the case of the TTP and TTIP, excluding the emerging global trading players, such as China, India and Brazil, might have a perverse effect. As we have seen with attempts by the BRICS to create their own Development Bank as a way to counter-balance the World Bank, it is not impossible to have a similar scenario on the trade front, where large developing trading nations may create their own alternative system. On this point, much attention will be on the RCEP, which includes India and China, to see to what extent they will be reactive to the TTP and TTIP. Such 'competitive liberalisation' (Bergsten, 1995; Baldwin, 2014) may derail the global trading system.

⁴ See http://www.ecipe.org/media/publication_pdfs/OCC22014_.pdf

Third, if concluded successfully, it is feared that 'WTO plus' and 'WTO extra' issues may find their way to the negotiations table at the WTO, in an attempt to 'multilateralise' some of the key provisions of mega-trade deals.

On the positive side, it is argued (Baldwin, 2014) that those mega-trade agreements might help to address the systemic issues of the proliferation of multiple regional trade agreements and the complication that arises from the application of their rules of origin (the "spaghetti bowl" effect).

Some analysis (Baldwin, 2014) highlight the potential benefits of regulatory convergence, including for third countries, although first-movers, that is members of the mega-trade deals, are likely to face lower costs in bringing their products to compliance with the new standards. It is argued that once standards are adopted, firms in other nations may also benefit from accessing the members' markets that would have harmonised their standards. However, mutual recognition of norms is expected to apply to members of the mega-trade deals only.

4.2. Africa

4.2.1. Preference erosion

On the tariff side, although the TTP and TTIP are expected to be mostly about rules, all African countries benefit from some degree of tariff preferences from the EU and the US. In the EU, least-developed countries (LDCs) benefit from duty-free quota-free (DFQF) market access under the Everything But Arms (EBA) initiative, countries that have recently concluded an EPA (with the exception of South Africa) will also get full DFQF market access to the EU in exchange of reciprocal, though asymmetric openness, North African countries trade under the preferential regime of the EUROMED Agreements and other developing countries benefit from the unilateral preferences extended under the Generalized System of Preferences (GSP). In the case of the US, some 40 countries (the number varies in line with US Presidential determination) are eligible for preferences under the Africa Growth and Opportunity Act (AGOA), which extends duty-free access for a wide range of products, including items such as apparel and footwear, wine, certain motor vehicle components, a variety of agricultural products, chemicals and steel, amongst others.

In that sense, elimination of tariffs in the context of TTIP or TTP negotiations is likely to have significant impact on the margins of preference that African countries enjoy. The TTP will have more impact than the TTIP, as it includes a number of Asian countries that are direct competitors of textiles or other manufacturing products from Africa.

The RCEP and the FTAAP are also likely to have significant implications on African economies. For instance, in 2005, at the Hong-Kong WTO Ministerial Conferences, Ministers agreed that *"...developed-country members shall, and developing-country Members declaring themselves in a position to do so should, provide duty-free and quota-free market access on a lasting basis, for all products originating from all LDCs by 2008..."*. This was finally tempered by an 'escape clause' stating that *"Members facing difficulties at this time to provide market access...shall provide duty-free and quota-free market access for at least 97% of products originating from LDCs defined at the tariff line level..."* while taking steps to progressively achieve full DFQF access for least-developed countries (ICTSD, 2013). In line with these commitments, India launched its Duty-Free Trade Preference (DFTP) scheme in 2008, with a view to providing duty-free access to 85% of its tariff lines by 2012. China also initiated a duty-free scheme in 2010 with an initial 60% coverage but with the objective of extending zero-tariff treatment to 97% of its tariff lines.⁵ One can therefore expect that non-LDCs, members of the RCEP and FTAAP are likely to benefit from significant tariff cuts, if these FTAs are ambitious in terms of tariff coverage.

⁵ See full article here <http://www.ictsd.org/bridges-news/bridges-africa/news/duty-free-quota-free-market-access-what%E2%80%99s-in-it-for-african-ldcs>

4.2.2. Rules-taking

As already mentioned, mega trade deals, in particular those involving developed countries – mainly the TTP and the TTIP, will be mainly about regulatory frameworks. They are expected to aim at regulatory convergence and achieve deeper integration in areas such as services and investment.

The likely impact on African countries will depend on the **level of dependency** on countries' trade on the EU or US markets. Today, on average, about 40% of Africa's trade is destined to EU or US markets. Therefore, the higher the level of dependency, the higher will be the impact of 'standards-taking', as African companies will have to adapt to new sets of norms, that they would not have negotiated. However, regulatory convergence may be a positive thing, if third countries are allowed to benefit from such convergence. It may reduce significantly the cost of compliance to different rules.

4.2.3. Overall possible impacts:

According to some estimates, the overall impact of **EU-US TTIP** is expected to be lower than the **US-Pacific TTP** on African countries because trade structures vary significantly. The TTP will involve a number of developing countries in Asia that are direct competitors to access the US market. The combined effect of preference erosion and new norms might give a significant competitive edge to Asian economies over African economies. The preference margins under AGOA will be significantly eroded.

With the TTIP, the EU and US are both developed economies, which are already interdependent in their trading patterns. They are both highly integrated in the global value chains, at the highest rung of the value ladder. There may be complementarities, at least in the *short term* for African countries, because countries are major suppliers of inputs and raw materials to EU and US. However, in the *medium to long term* it may have a perverse effect. As countries are stepping up efforts to move away from being raw material providers towards industrialisation, these agreements might have significant **lock-in** effects. They may unintentionally marginalise African countries, by becoming even more dependent on the sourcing of raw materials. Rules set to achieve this objective, will therefore make it more difficult for African countries to add value to their raw materials and therefore upgrade their participation in global value chains. Hence this may have impacts on industrialisation prospects.

5. Way forward

If successfully concluded, mega-trade deals will set new benchmarks for the global trading system. These negotiations are however going to be tough and may not be concluded anytime soon, given their complexity, both in terms of content and in terms of politics. The timing and the outcomes are for the moment therefore unknown. However, there is no time for complacency, since they will have major impacts on the governance of the global trading architecture. What could therefore be the response of African countries?

It is clear that the '*do nothing*' or '*wait and see*' responses are not a good strategy, in particular as the African continent becomes more and more significant on the geo-political scene.

Similarly, the '*reject*' strategy may not be helpful, because the mega-trade deals will happen, if countries involved in them decide to move ahead and there will be very little third countries could do about it.

Finally, *retreating in protectionism* may accentuate the marginalisation of the continent because experience has shown (including at the WTO, accession processes have proved tougher for countries that joined the WTO after 1995) that in a globalised world, countries that are part of the front-runners category tend to have better deals than later-comers.

It may therefore be appropriate for African policy makers to think ‘outside the box’ to forge strategic responses, by taking bold steps within their own intra-Africa trade agenda, as a way to mitigate the ‘tsunami effect’ of mega-trade deals. It may also be appropriate to forge strategic alliances with other non-participating countries, in order to take the lead at the WTO to address some of the issues that might affect the global trading system, once those mega-trade deals are agreed.

5.1. Forging strategic responses

The following responses may be considered:

1. At the national level, African countries could take **unilateral initiatives** to calibrate their own regulatory environments in a way that is in line with first best norms and standards. Not doing so may lead to being *de facto* rules takers.
2. In the same vein, a **regional/continental trade** agenda could also work towards regulatory convergence, at least to reduce the cost faced by firms operating across borders. This is a first step to reduce trade costs. At the same time, as mega-trade deals deepen their rules-based negotiations, it may be timely to work together to ensure that regional/continental negotiations on rules and regulations converge to what may otherwise be the new trends. In this sense, the Boosting Intra-Africa Trade Agenda is a potential opportunity for African economies to address the spaghetti bowl effects of rules in general. That will help minimise the costs of trading with third parties.
3. African countries/regions are increasingly looking beyond their own regional trade agenda to deepen their trade ties with their main trading markets. The EPAs are a case in point. The US has also signalled its interest in having FTAs with African countries/regions in the future. It is therefore important to ensure **proper sequencing** by expediting the completion of regional/continental agenda and to address issues such as regional preferences in tariffs and other cross-border barriers to trade, as well as regulatory measures. This will prevent the risk that as the EU and US conclude advanced FTAs in Africa, standards negotiated in those agreements might supersede those that have been agreed among African countries.
4. It may also be interesting to start a conversation both with the EU and the US, to put the **harmonisation of their preference schemes** to Africa on the TTIP Agenda (see Draper, 2014). For instance, as it currently stands, African countries encounter multi-layered compliance requirements, depending on whether they are LDCs (EBA for the EU and AGOA for the US), EPA-signatories, or GSP beneficiaries. This leads to significant costs to firms seeking to export to these markets and having to comply with complex requirements and different rules of origin. It also makes it difficult to use inputs from other countries (therefore building regional value chains) in order to export transformed products to the EU or the US. Engaging the EU and the US simultaneously to address the complexity of multi-layered compliance to regulations will significantly reduce the costs of African exporting companies, as the EU and the US move ahead with their FTA.
5. In line with the proposal above, it may also then be appropriate to seek **‘extended’ mutual recognition** of norms and standards. For instance, if African products meet the standards to export a particular product to the EU market, and if, in the context of the TTIP the EU and the US have agreed to mutually recognise the standards for that same product in the context of the TTIP, African countries should be able, by extension, to access the US market for that particular product as the standards have been mutually agreed in the TTIP. This is, to some extent, in the same spirit as the “MFN” clause that the EU had asked of EPA-signatories.

5.2. Forging strategic alliances

There is a sense that the next step, once the mega-trade deals are concluded, might be an attempt by big players to “multilateralise” some provisions at the WTO. It is therefore essential for the Africa group to play a leading role at the WTO to ensure that the multilateral system continues to work to the benefit of developing countries, while at the same time keeping pace with the evolving global trading architecture. This is going to be a difficult balance, as the sense that rules are being set outside the WTO system is a strong one. However, if the WTO is to survive, and more importantly, play its role, as an organisation where decisions are made by consensus, and therefore inclusive, it is important that African countries take a key leadership role to ensure they are not marginalised. Alliances, therefore, with other like-minded countries, including emerging global partners, in issues of common interest is key.

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